

A nonprofit organization whose sole activity is the operation of a 'scholarship' plan for making payments to pre-selected, specifically named individuals does not qualify for exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954.

The Internal Revenue Service has been asked whether an organization which operates a subscription 'scholarship' plan in the manner described below qualifies for exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954.

The organization's stated purpose is to encourage and promote the advancement of education by providing college scholarships and other assistance to designated students. The organization established a plan under which it enters into so-called 'scholarship' agreements with subscribers. Under the agreement a subscriber agrees to deposit, either in periodic payments or in a lump sum, a specified sum with a designated bank. At the same time, the subscriber nominates a named child not over a specified age at the time the agreement is entered into who will receive a 'scholarship' from the organization if he matriculates at a college. The agreement further provides that from the funds deposited by a subscriber a specified amount shall be withdrawn by the organization as the subscriber's enrollment fee in the plan; that the remaining funds on deposit shall continue to belong at all times to the subscriber; but that all interest earned on such deposited funds shall be transferred to the organization.

If a subscriber wishes to withdraw from the plan at any time prior to the fulfillment of his commitment, or if he fails to carry out his part of the agreement, he may withdraw only his principal, less enrollment fee, from the account. However, in the case of a withdrawal the nominee's eligibility for a 'scholarship' is terminated. If the nominee does not for any reason matriculate at a college, the subscriber may name a substitute nominee of the same age as the original nominee.

The enrollment fees and interest are used by the organization to defray its operating expenses and to pay the 'scholarships' of those nominees who ultimately do attend college.

Section 501(c)(3) of the Code provides for the exemption from Federal income tax of organizations organized and operated exclusively for charitable purposes. However, to be exempt under this section of Code, an organization must serve a public rather than a private interest. It must not be operated for the benefit of private interests such as designated individuals. See section 1.501(c)(3)-1(d)(1)(ii) of the Income Tax Regulations.

Under these agreements, whereby the organization pays 'scholarships' to pre-selected, specifically named individuals

designated by subscribers, the organization is serving private interests rather than public charitable and educational interests contemplated under section 501(c)(3) of the Code. Therefore, it does not qualify for exemption from Federal income tax under that section. Compare Revenue Ruling 56-403, C.B. 1956-2, 307, which holds that awarding scholarships by a foundation solely to undergraduate members of a designated fraternity will not preclude the foundation from exemption under section 501(c)(3) of the Code.